The Market in Review

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"It is better to be feared than loved, if you cannot be both. It is far safer to be feared than loved."

"I'm not interested in preserving the status quo; I want to overthrow it."

- *"The Prince" by Niccolo Machiavelli*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	33,795	+1.72%	- 7.00%
S&P 500	4,363	+1.74%	- 8.45%
TSX	21,250	+2.35%	+ 0.13%

The Russian Curse

We joke about a curse around here, that every time I take a vacation, something bad happens. I took a week off and what bad thing was it this time around? After months of growing tensions, Russia invaded Ukraine. The news has changed so quickly that I have written and torn up versions of *The Market in Review* at least three times.

An invasion was supposed to be almost impossible. Russia had over 600,000 men when they last invaded Ukraine in 1944 – how could they manage with just 150,000 in 2022? Surely they can't!

And yet, they did anyway.

Despite the horrific human losses, does it matter to the world economy? On the surface, Ukraine's economy is just 0.14% of global GDP and Russia's only 3% (*Tradingeconomics.com*). U.S. companies, as measured by the S&P 500, get less than 1% of their revenues from Russia. So why would the world care about Ukraine?

Aside from supporting a fledgling democracy, the world certainly cares about Ukraine's commodities. The country is 4th in the world in terms of the total value of its commodities, from uranium to iron ore to coal. In agriculture, it is even more important to the world. Ukraine is the largest producer of sunflower oil in the world, the second largest producer of barley, and the third largest producer of corn. It holds 25% of the world's volume of black soil, which is why it is known as the *Breadbasket of Europe*.

When you combine Russia's commodities - Russia is the world's third largest oil producer and supplies 60% of Europe's thermal coal – you can start to see the impact of the war. Without Russia and Ukraine's energy, Europe freezes. Without their crops, the world starves. So yes, the conflict matters.

It also matters because it was an unprovoked attack on a democratically-elected country. Perhaps Russia sees it differently because it feels hemmed in by NATO, but in today's world, that is hardly an excuse to bomb apartment buildings and schools. Russia's intent was likely to take advantage of a weakened, distracted, and energy-dependent West. The result could not have been more opposite. The U.N. has voted more cohesively that at almost any time in its history, Germany has completely reversed course on its military spending and will almost double its expenditures going forward. Germany will now build two new liquid natural gas (LNG) terminals to replace Russian gas in an effort to end its dependence on Russian gas. Perennially-neutral Sweden and Switzerland are donating weapons and choosing sides. Ukraine itself has united under their besieged president, Volodymyr Zelenskyy, a former comedian turned politician.

Even China is backing away from Russia. China has offered itself as an intermediary to ceasefire discussions and are reportedly quite angry with Mr. Putin.

The good news is that U.S. intelligence sources say there is little risk of nuclear confrontation at this point. There have been no signs of activity at any of the Russian bases they watch. The bad news is that Putin is increasingly erratic with some even questioning his health. And, of course, the Russian army is known for its perseverance in war.

"It does not matter how slowly you go as long as you do not stop."

- *Russian proverb*

A younger Vladimir Putin liked to tell a story of chasing rats in his Soviet-era apartment building where he grew up. One day, he chased a particularly large rat and cornered it. As he approached it with a stick, the rat suddenly leaped up and bit him. Putin said he learned a valuable lesson that day. To avoid getting bitten when cornering an enemy, you need to leave it a way to escape. The irony is that today, he is the rat in his own story, trapped in a corner of his own making. His demands that NATO leave Poland, the Balkans, and the Baltic States – plus removing all of NATO's nuclear weapons from Europe - are complete non-starters.

Our chief strategist says to watch China. If they emerge as a power broker, their status rises immensely. They are also eyeing western resolve because they have their own potential Ukraine situation in Taiwan. In some ways, this crisis only makes the west stronger. It has united NATO, forced Germany to increase its defenses and rethink its dependence on Russian oil and gas, and it is making China reconsider its own expansion plans.

The Next Few Months

While this crisis – and the stock market decline – seems like the worst thing to ever happen, it isn't. In fact, every year there is at least one major headline that shakes stocks. Here's a list that goes back just to 2000:

Year	S&P 500	S&P/TSX	Headline
2000	$1,320.28	$8,933.68	Y2K aftermath | Tech bubble
2001	$1,148.08	$7,688.41	Recession, 9/11
2002	$879.82	$6,614.54	Corporate Accounting Scandals
2003	$1,111.92	$8,220.89	Bush Jr. declares War in Iraq
2004	$1,211.92	$9,246.65	U.S. has massive trade & budget deficit
2005	$1,248.29	$11,272.26	Record oil & gas prices
2006	$1,418.30	$12,908.39	Housing bubble bursts
2007	$1,468.36	$13,833.06	Sub-prime loan crisis
2008	$903.25	$8,987.70	Banking and credit crisis
2009	$1,115.10	$11,746.11	Jobs Recession
2010	$1,257.64	$13,443.22	Sovereign debt crisis
2011	$1,257.60	$11,955.09	Eurozone crisis
2012	$1,426.19	$12,433.53	U.S. fiscal cliff
2013	$1,848.36	$13,621.55	Federal Reserve begins to taper
2014	$2,058.90	$14,632.44	Ebola outbreak I Annexation by Russia
2015	$2,043.94	$13,009.95	Commodity sell off
2016	$2,238.83	$15,287.59	Brexit
2017	$2,673.61	$16,209.13	Oil Price Decline
2018	$2,506.85	$14,322.86	Equity Markets Sell Off
2019	$3,230.78	$17,063.43	U.S.-China Trade War
2020	$3,756.07	$17,433.36	COVID-19 Pandemic
2021	$4,766.18	$21,222.84	Record Inflation

Source: FactSet; Priced as of February 22, 2022

To me, this crisis is most like the invasion of Kuwait by Iraq in 1990. Both were huge oil producers and the conflict sent oil prices soaring. Iraq's

Republican Guard was supposedly one of the toughest armies in the world and the invasion caused stocks to drop 20% in just a couple of months. A year later? After Operation Desert Storm, markets moved to new highs and Iraq became an afterthought.

Unless this escalates a lot further, the next few months will be a perfect market for traders, but a tough one for investors. News is likely to drive stocks up, down, and sideways for several months as this crisis sorts itself out. But rest assured, it will sort itself out. Stocks move because of earnings and the economy, and conflicts are usually too small to make much of a dent in either.

While many people worry about a new bear market, the reality is that we have been in one for the last six months in parts of the market. Amazon (**NASDAQ AMZN**) is down 20% since last summer, Tesla (**NASDAQ TSLA**) is down 30%, and Zoom (**NASDAQ ZM**) sits at -70%. Technology, cryptocurrencies, and vaccine makers (which collectively rose to absurd valuations after the Covid panic), are now are getting their comeuppance.

After a 70% decline, however, some might actually represent good value today.

Investment Ramifications

Could 2022 be any different from 2021? Central banks are in a pickle because they need to raise interest rates to slow inflation, yet growth is slowing already due to the conflict in Europe. Canada just raised interest rates from 0.25% to 0.50% this week, our first rate hike since 2018. The U.S. Federal Reserve has now stated they will likely do the same in a few weeks. There were fears they would be more aggressive and hike by 0.50% right away.

In times of peace, trade is easy and goods are in abundance. In times of war, barriers and borders rise, making goods harder to get. We are seeing this now in commodity prices – the long era of declining prices of “stuff” is over. Fertilizer, oil and gas, pipeline, iron ore, and even coal stocks have rallied sharply, allowing Canada’s S&P/TSX to remain flat this year compared to the S&P 500 at almost -9%.

Commodities are pushing inflation higher and faster than anyone expected. Wheat is up 40% in just the last two weeks, the highest since 2008. Aluminum is at record highs and zinc is at 15-year highs.

Most importantly, the CRB food index closed at a record high, thanks to wheat and corn prices. Egypt gets 86% of its wheat imports from Russia & Ukraine and remember, it was rising food costs helped spur Arab spring protests a decade ago. When people can't afford to eat, they get angry.

Gold – Gold is enjoying its time in the sun due to the "flight to safety". In the short term, Russia may be forced to sell some of its U.S. $150 billion in gold reserves (*source: Statista*), meaning gold could suffer if the conflict drags on. However, gold is also sensitive to inflation, which is rising at a rapid pace. Gold bullion and gold mining companies are worth a look if gold takes a meaningful drop on rumours of Russian sales.

Copper, fertilizer, iron ore – The last time the world was divided into trading blocs was during the Cold War from 1947-1991. This also coincided with commodity scarcity and the inflation of the 1960's and 1970s. We may be returning to such a time, particularly since exploration for commodities has been a low priority for the last decade. The same thing applies as for gold – these are all ahead of themselves due to the Ukraine conflict, but copper and fertilizer stocks, in particular, are buys if their prices cool off. Copper is in great demand due to electric cars, and the world always needs fertilizer to grow its crops.

Oil

Meanwhile, the world is hyper-focused on energy and oil prices. Will Russia freeze Europe by stopping shipments of oil and gas? Russia supplies 65% of Germany's natural gas needs. Or will countries follow Canada's lead and suspend Russian oil and gas?

Sanctions on banks and shipping firms mean few countries want to touch Russian oil with a 10-foot pole right now. Wales turned away a full Russian oil tanker and many other ships are scrambling to unload their cargoes. This has driven oil prices to over U.S. $112 per barrel this week. High oil prices are not good for the economy, especially as we are just opening up after the Covid-19 pandemic and travel demand is just starting to recover.

Almost all our portfolios hold a little oil, and this has helped performance so far in 2022. Any sign of peace, a deal with Iran, or a global slowdown could send oil prices lower. Even so, the advice is the same as with the other commodities: high prices are here to stay.

And Canadian oil may finally start to attract a premium. According to Joule Bergerson of the University of Calgary, "if the rest of the world's oil production were held to Canadian standards for flaring, total greenhouse gas emissions from every barrel produced would drop by 23 per cent — the equivalent of taking 100 million cars off the road." (source: National Post)

In the short term, there is likely a good trade coming in growth stocks. Many have been hammered down since the peak last summer.

Long-term, we may be in for a period like 2000-2010 when technology stocks traded in a range for years, which was great for traders but poor for investors. Similarly, commodity and value stocks may dip after their sharp Ukraine-led rises. In that same 2000-2010 period, however, these stocks were just starting to climb.

We are in a new era.

"So the last will be first, and the first will be last."

- *Matthew 20:16, New International Version Bible*

Savings Rates

A month ago, we saw 1-year guaranteed investment certificates (GICs) yielding 1.6% for 1 year and 2.25% for 2 years. Thanks to the recent interest rate hike, we are now at 1.85% for 1 year and 2.5% for 2 years. Savers are finally being rewarded for staying safe.

The Roaring 2020's

Despite all the gloom, there are some who see nothing but sunshine on the horizon. In his book **The Cloud Revolution,** Mark Mills details how the decade ahead could see miracles unfold due to the convergence of three new areas:

1. Information in the cloud.
2. Materials science.
3. Machines.

The internet revolution of 2000 was the wiring of our planet. Suddenly, millions of computers could talk to one another. This unleashed thousands of new applications and inventions, from the cell-phone to Netflix.

Today, the cloud – a giant 'brain' made up of millions of computers – is a whole new leap forward. I have a friend who processes radar data. It took him an hour to process data on his own high-speed computer. Using Amazon's AWS cloud service, it takes him 12 seconds. The miracle of the Covid-19 vaccine invention came about because of the massive computing power of the cloud, and it has only accelerated since.

At the dawn of the 20th century, mankind used about a dozen key materials – iron, lead, copper, calcium and silica (for cement), rubber – to make just about everything. Today? We use over 200 of the elements in the periodic table, and more in ways not even found in nature. My new Lululemon athletic shirt has zinc embedded in the fabric to stop odours. How do they bind zinc to cloth? Lithium is the new wonder metal due to its use in batteries, and graphene (mostly used in pencil lead) could lead to diamond-hard objects that are lighter than wood.

Most people think of robotics when they think of machines. Now take that down to the miniature scale and you'll find nano-robots being created for medical purposes. 3-D printers now make everything from airplane parts to human organs.

These three areas of knowledge have been growing rapidly for almost 20 years. This is about the time it takes from first invention to widespread use. The diesel engine, for example, was invented in 1893 but it took until 1911 for the first diesel-powered ship to arrive. Stronger steel and heat-resistant piping had to be invented first. It is the convergence of the three new waves of innovation together that will bring about the miracles of the decade ahead.

For example, a Victoria professor is using medical data from around the world in a massive machine-learning system to discover tests and treatments for sepsis, one of the biggest and least-studied diseases. Other doctors have used new materials and a 3D printer to create a small, functioning, human heart.

Switching over to geopolitics for a moment, it is easy to understand the frustration of both Russia and China with the U.S. Despite is divisions and repeated failures, America has so many advantages in the knowledge economy:

- Of the 4 firms that dominate the production of software essential for computer and communications chips, the U.S. is home to 3 of them.
- Of the 4 companies that control 90% of the world's machine tools, the U.S. is home to 3 of them.
- The U.S. is the centre of the world's cloud infrastructure.
- The U.S. is home to half of the world's "unicorns" – those next-generation private companies worth over $1 billion.

- The U.S. is home to a majority of the world's leading research universities and half of all Nobel Prizes in Science, Medicine, and Economics have gone to Americans.

Until this huge lead changes, the next wave of invention and massive wealth will happen over here, not in Russia or China.

(data sourced from "The Cloud Revolution – How the Convergence of New Technologies Will Unleash the Next Economic Boom and a Roaring 2020's" by Mark P. Mills)

China is Watching

While attention is focused on Russia, we also need to keep our eyes on China, for it has the same territorial ambitions for Taiwan that Russia has for Ukraine.

America and the west have weaponized the financial system to combat Russia. That country's banks have been cut out of the global messaging system called SWIFT, their commodities are tied up in ports because credit lines have been refused, and their foreign reserves held in foreign capitals have suddenly been frozen.

In the short-term, this is effective and brilliant. In the long-term, however, it may lead to the erosion of the U.S. dollar as a global currency.

It's not that Russia didn't prepare. In 2010, Russia owned U.S. $176 billion in U.S. Treasury bonds. By 2021, this was down to just $2.6 billion. Where did they put the money? Much of it went into gold and other currencies. Their problem was that approximately half of these reserves were held outside of Russia and are now being frozen. China, with its *$2 trillion* in U.S. Treasury bonds is in an even more vulnerable position if it invades Taiwan today. China has also been steadily increasing its gold holdings, with almost all domestic gold production quietly stashed away within the country. The Chinese mining industry is acquiring other gold miners in places like Africa.

It would be impossible for China to hold all of its $3.2 trillion in hard reserves in gold – there just isn't enough available. However, it can certainly hold more than it does, and it probably will.

What is the lesson China has learned from Russia? Financial assets can be seized anywhere, and gold held offshore is just as vulnerable. China won't make that mistake. And until cryptocurrencies mature, expect to see China's gold reserves continue to climb.

Meanwhile, once this crisis is over, the U.S. dollar will have lost a little more of its sheen. Money is only valuable when everyone trusts it, and if you can't use it when you most need it, do you really trust it as much anymore?

A more in-depth reading of this can be found at:

https://asiatimes.com/2022/03/gold-will-soar-as-china-seeks-us-dollar-alternatives/

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